IN THE

Supreme Court of the United States

OCTOBER TERM, ~~1948~~ 1949

No. 55

IN THE MATTER

OF

CALTON CRESCENT, INC.,
Debtor.

MANUFACTURERS TRUST COMPANY, as Trustee under an Indenture made by the Debtor under date of September 27, 1933, and individually,
Petitioner,

against

REGINE BECKER, EMILY K. BECKER and WALTER A. FRIBOURG,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF

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Citations:

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

To the Honorable Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, Manufacturers Trust Company, as Trustee under an indenture made by the debtor, and

individually, respectfully prays that a writ of certiorari issue to review an order and judgment of the United States Court of Appeals for the Second Circuit which was entered March 3, 1949, and which affirmed an order of the United States District Court for the Southern District of New York dated July 20, 1948, which in turn affirmed an order of a Referee in Bankruptcy dated July 11, 1947 overruling objections to claims filed by the respondents in a proceeding under Chapter XI of the Bankruptcy Act.

Opinions Below

The opinion of the Referee (A. 100-101*) was dated July 2, 1948. The opinion of the United States District Court for the Southern District of New York, Goddard, J. (A. 116-122) was filed on June 20, 1948 and is reported at 80 Fed. Supp. 822. The opinions in the Court of Appeals for the Second Circuit (C. 8-25) were filed on March 3, 1949 and have not been reported.

Jurisdiction

The order and judgment of the United States Court of Appeals for the Second Circuit, sought to be reviewed, was entered on March 3, 1949. Jurisdiction to issue the writ requested is found in Section 24 (c) of the Bankruptcy Act and in Title 28, United States Code, Section 1254 (1).

Questions Presented

The questions here presented are whether directors of a corporation may purchase its debt securities while it

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* References indicated by the letter "A" are to the pages of the appendix to the petitioner's brief as appellant in the Court of Appeals, which is part A of the transcript filed in this Court. References indicated by the letter "C" are to Part C of the said transcript.

s insolvent and enforce them in bankruptcy at their full face value rather than be limited to the actual cost; and, if not, whether their relatives and business associates may, in cooperation with these fiduciaries, do what the directors themselves may not do.

Summary Statement of the Matters Involved

This is a proceeding under Chapter XI of the Bankruptcy Act. The review here requested involves the treatment of claims filed by the three respondents, to which claims your petitioner, both in its capacity as Trustee under the debtor's indenture dated September 27, 1933, and individually, filed objections. The claims of the respondents were based upon certain debentures issued under such indenture and the objections sought to limit such claims to the amount paid by each of the respondents for the debentures respectively. The amounts of these claims as filed and the cost to the respondents of the debentures upon which the claims are based were as follows (A. 75-76):

	Amount of Claim	Cost
Regine Becker	$44,500.00	$3,060.63
Emily K. Becker	52,800.00	5,010.00
Walter A. Fribourg	50,000.00	2,124.80

The dividend payable to the creditors in this estate is 43.61%. Consequently there is involved upon this petition $54,042.10, being the difference between the dividend on the face amount of said several claims and the cost of the debentures to the respondents.

The debtor's only asset was an apartment house in New Rochelle, New York, known as the Calton Court Apartments, which it had acquired from a prior corporate owner

in an equity reorganization. In that reorganization the debtor was formed to take title to the premises and there were issued to the depositing bondholders of the former owner debentures and stock of the debtor, each such bondholder receiving $50 of such debentures and one share of such stock for each $100 principal amount of the old bonds (A. 86, 87).

In pursuance of this plan there were issued and were outstanding $254,450 principal amount of the debtor's debentures. Your petitioner was named as Trustee under the indenture pursuant to which these debentures were issued and has at all times continued to act in that capacity (A. 88).

The reorganization was consummated and the premises conveyed to the debtor in 1933 (A. 88). By early 1942 the debtor was in default under the terms of a mortgage on its property (A. 89) and during the years 1942, 1943 and 1944 it was in a precarious condition, operating continuously at a loss (A. 88).

The debentures in question were purchased by the respondents in the years 1942 to 1945 (A. 75-76) and during all of this period the debtor was insolvent (A. 98).

At the time of the acquisition of these debentures two of the directors of the debtor were Sanford Becker and Norman S. Becker who are brothers. The respondent Regine Becker is the mother of these two directors and the respondent Emily K. Becker is the wife of Sanford Becker (A. 91-92).

The respondent Walter A. Fribourg was a business associate of Sanford and Norman S. Becker, having desk space with them in their office (A. 27-28). Of his relationship with such directors the District Judge stated that he was persuaded "that the evidence warrants a finding that the relationship between Fribourg and the

Beckers was of such a nature with respect to the affairs of the debtor so as to treat his (Fribourg's) proof of debt as a proof of debt of a director" (A. 120).

The purchase of these debentures was apparently carried out as a concerted plan by the Becker brothers and Fribourg. All of the purchases of the respondent Regine Becker were made through an account in the name of Fribourg maintained with one E. Henry Sondheimer & Co. (A. 50-51, 76) and part of the debentures of the respondent Emily K. Becker were acquired in the same fashion (A. 76). The respondents Regine Becker and Emily K. Becker exercised no judgment of their own in purchasing their debentures, their purchases having been handled by Sanford Becker as their agent (A. 97-98).

A considerable part of Fribourg's debentures were acquired as a result of a circular letter sent to the other debenture holders in 1944 under the name of his brother-in-law, one Winter (A. 77-78) and these transactions were handled by Norman S. Becker (A. 58-59) in furtherance of a plan apparently worked out by Sanford Becker (A. 34-38).

The Becker brothers became directors of the debtor on April 7, 1942, and from that time on the office of the debtor was maintained in their offices and their nominee, as managing agent, operated the property (A. 20-22). After June 28, 1944 the three remaining directors of the debtor (there were five in all) resigned and their places were filled by nominees of Sanford Becker, so from that date on the board of directors was completely under the control of the Becker brothers (A. 22-25).

The property was sold in January 1946 for a sales price which ultimately enabled the debtor to be liquidated and resulted in the dividend to creditors above referred to of 43.61% (A. 93).

On May 23, 1946 the debtor instituted the present proceeding by filing a petition under Chapter XI of the Bankruptcy Act (A. 93).

Upon the filing of claims by the respondents, your petitioner objected to said claims upon the ground that while the debtor was insolvent its directors and persons such as the respondents affiliated with them, related to them or acting in conjunction with them, could not profit from any dealings in debt securities of the debtor and at best they might recover from the estate of the debtor only the amounts actually expended by them with interest. This objection, together with an objection based upon overreaching and failure to disclose, which is not here pressed, was overruled and the claims allowed in full by the Referee. His determination in that respect was affirmed by the District Court (Goddard, J.) whose decision in turn was affirmed by the Court of Appeals (Learned Hand, C. J. dissenting).

The Grounds on Which the Decisions of the Courts Below Rested

While the Referee, the District Court, and the Court of Appeals all overruled your petitioner's objections, as has been stated, no two of them agreed upon the basis for their conclusions.

The Referee took the position that, with certain exceptions not here pertinent, a director, and consequently his associates, may acquire unmatured obligations of the corporation of which he is a director and enforce the same for the full face amount thereof, even if at the time he so acquired the obligations said corporation was insolvent. The Referee based his conclusion principally upon this Court's first decision in *Securities and Exchange Commis-*

sion v. Chenery Corp., 318 U. S. 80, a case which was not in point, involving as it did the reorganization of a public utility under Sections 6 and 11 of the Public Utility Holding Company Act of 1935, where the subject company was not insolvent but was being reorganized in order to divest itself of certain subsidiary companies in accordance with the provisions of that statute.

In the District Court, Judge Goddard held that cases condemning transactions by directors in the debt securities of an insolvent corporation did not cover the situation where the corporation, although insolvent in a bankruptcy sense, is still a "going concern", applying what he deemed to be the rule as laid down in decisions of the New York courts (A. 121-122). Of course, in the instant case the debtor was a "going concern" only so long as the Becker-Fribourg group, who were in complete control, permitted it to remain so.

The prevailing opinion of the Court of Appeals was written by Swan, C. J., Chase, C. J. concurring. The dissenting opinion was written by Learned Hand, C. J.

The majority took the position that the matter was not governed by decisions of the New York courts since the bankruptcy law, including what the federal judges think to be equitable, determines what dividends shall be distributable to a claimant (C. 10); that the wrong, if any, had been done to those who had sold their claims at a price less than the dividend they would have received had they retained them; that where, as here, the contest is between the unwronged cestuis (*i.e.*, the debtor's other creditors) and the directors, if the former are to prevail it can be only as a disciplinary measure; that if the doctrine be recognized as a disciplinary sanction within the discretion of the court to impose or withhold, then each case should depend on its own circumstance, and conse-

quently in the case at bar, where there was no overreaching of the sellers, the majority was not convinced that the circumstances were such as to require the imposition of the sanction, even if the proofs of debt had been filed by directors of the debtor themselves (C. 17-20).

The majority stated further that these particular respondents were not directors or officers of the debtor, that their own funds were invested, and that no officer or director of the debtor had any interest in the debentures purchased; that as to the Becker ladies, while they exercised no independent judgment and are chargeable with the knowledge of their agent, Sanford Becker, there was no overreaching of the sellers. As to the respondent Fribourg, the majority felt that there was nothing in the record to justify a finding that he did more than invest his own funds on a "tip" received from an officer or director of the debtor (C. 20-22).

Judge Learned Hand, in dissenting, pointed out that no fiduciary deals with his beneficiary on terms of equal advantage, that if he is to avoid that restriction he must be able to point to some circumstance which will excuse him; that there was a distinction to be taken between purchasers of stock and purchasers of debt securities; that before accepting the excuse in the case of debts the burden should be put on the director of proving not only that he genuinely expected by a composition to continue the business but that his expectation was well founded, and that nothing short of both would serve as an excuse, and that neither was proved in the case at bar (C. 23-25).

As to the Becker ladies, Judge Hand felt that they were chargeable with what their agents knew and were not bona fide purchasers. As to Fribourg, Judge Hand stated that the correct answer was not altogether clear but it would have been necessary to find it only in case the majority had agreed with his disposition of the chief issue (C. 25).

Reasons Relied on for Allowance of Writ

1. The decision below runs counter to long established and uniformly applied principles with respect to the fiduciary duties and obligations of directors of an insolvent corporation and is erroneous. It has heretofore been consistently held that directors may not traffic in the debt securities of their insolvent corporation and thereafter in bankruptcy proceedings enforce their claims upon such securities beyond the amount which they actually paid for them.

Yet in this case the majority of the Court of Appeals has held to the contrary upon the ground that it did not appear that the sellers of the purchased securities had been overreached.

We know of no federal decision where such a principle has been enunciated. On the other hand, that directors' claims purchased during insolvency should be limited to the amount paid has been held in the following cases:

In Re Van Sweringen, 119 F. 2d 231 (6 C.C.A., 1941; cert. den. sub nom. *Terminal & Shaker Heights Realty Co. v. Van Sweringen*, 314 U. S. 671);

In Re Norcor Manufacturing Co., 109 F. 2d 407 (7 C.C.A., 1940; cert. den. 310 U. S. 625);

Monroe v. Scofield, 135 F. 2d 725 (10 C.C.A., 1943);

In Re Los Angeles Lumber Products Co., Ltd., 46 Fed. Supp. 77 (D.C.S.D. Cal. 1941);

In Re Jersey Materials Co., 50 Fed. Supp. 428 (D.C. N.J. 1943);

In Re Philadelphia & Western Railway Co., 64 Fed. Supp. 738 (D.C.E.D. Pa. 1946);

In Re McCrory Stores Corp., 12 Fed. Supp. 267 (D.C.S.D. N. Y. 1935).

While there has been no decision of this Court upon the matter, the decision below runs counter to the principles which have been enunciated by this Court in respect of the fiduciary obligations imposed upon directors. This Court, in *Pepper* v. *Litton*, 308 U. S. 295, a case in bankruptcy, pointed out that the bankruptcy courts were invested with equitable powers, that these powers exist in passing on claims presented by an officer, director or stockholder in the bankruptcy proceedings of his corporation, that a director is a fiduciary, that standards of fiduciary obligation are designed for the protection of the entire community of interests in the corporation, and that one who is in a fiduciary position cannot serve himself first and his *cestuis* second.

Judge Learned Hand in his dissenting opinion below (C. 23) expressed these principles in the following language:

> "The books are full of declarations that an insolvent holds his property in trust for his creditors; and, when the insolvent is a corporation, whose directors were concededly fiduciaries as to shareholders, they become doubly fiduciaries of the creditors upon insolvency. The shareholders have then lost any interest in the assets, and the directors must be fiduciaries of the creditors, if they are to be fiduciaries at all. We can start therefore with the principle universally recognized that, *prima facie*, no fiduciary deals with his beneficiary on terms of equal advantage; and that, if he is to avoid that restriction, he must be able to point to some special circumstance which will excuse him."

That the decision of the court below runs counter to the theory of decisions upon the subject in the federal courts, was also pointed out by Judge Hand when he said, apropos the contentions of the respondents (C. 23):

"That there is at least a prevailing belief in the federal courts to the contrary, the decisions discussed in my brothers' opinion make clear; they form a substantial body of opinion, which *Securities and Exchange Commission v. Chenery** did not disturb."

The prevailing belief to which Judge Hand refers is fully discussed in the very thoughtful opinion of the district judge in *In re Los Angeles Lumber Products Co., Ltd., supra*, 46 Fed. Supp. 77 (D.C.S.D. Cal. 1941).

Consequently the decision below creates confusion in a field where the law was settled, and, since there has never been a decision by this Court upon the question, it is submitted that there should be an authoritative determination of it.

2. The decision of the Court of Appeals in this case directly conflicts with decisions of the Courts of Appeals for the Sixth, Seventh and Tenth Circuits. These decisions are as follows:

Sixth Circuit—*In re Van Sweringen, supra*. There directors of three insolvent corporations, a year before the corporations went into bankruptcy, purchased debt securities of the debtors through the medium of a corporation formed by them and in the ensuing bankruptcy proceedings it was sought to enforce these claims at their face amount. It was held by that court that the claims should be limited to the amount actually paid for the securities, the court pointing out that the debtors were insolvent when the purchases were made, that a trustee can make no profit out of his trust and that the intervention of a dominated subsidiary corporation did not render the principle less effective.

* 318 U. S. 80.

Seventh Circuit—*In re Norcor Manufacturing Co., supra.* There, while the debtor was in a state court receivership, two and a half years prior to the filing of a bankruptcy petition, one Krueger (who was the principal stockholder and a director of the debtor), his attorney and members of his family purchased claims against the debtor and assigned them to a corporation formed for the purpose of enforcing them. It was held by that court that the claims should be limited to the amounts actually paid for them, the court asserting that Krueger and his attorney bore such a fiduciary relationship to the debtor corporation as to preclude them from purchasing claims of its creditors at a small fraction of their face value and using them as a foundation for a claim in excess of what was actually paid therefor.

Tenth Circuit—*Monroe v. Scofield, supra.* There the court expressly held (page 728) that where a corporation is insolvent a director is precluded from recovering more than he paid for a claim against the corporation unless by an order of the court or otherwise he has been shorn of all his power in the corporate management and his trust relationship has been fully terminated.

There are, therefore, decisions of three Courts of Appeals in other circuits, in two of which this Court denied certiorari, which are directly in conflict with the decision of the court below in the instant case.

3. This matter presents a question of recurring importance in the administration of the Bankruptcy Act. That this is so is manifest from the series of decisions over a period of years to which we have heretofore adverted.

It is a question which is to be encountered in every type of bankruptcy whether it be one of liquidation,

reorganization under Chapter X or of arrangement under Chapter XI.

The Securities and Exchange Commission obtained leave from the court below to file a brief *amicus curiae* in support of the petitioner's position, stating to that court:

> "This appeal includes issues of recurring importance in the administration of the Bankruptcy Act, particularly in connection with proceedings under Chapter X thereof (11 U.S.C. 501 *et seq.*) in which the Commission has a statutory interest."

It is to be assumed that up to this time, in view of the uniform flow of the decisions of the lower federal courts, such claims of directors and their relatives and associates have been treated upon the basis for which your petitioner here contends.

It is perfectly manifest that the decision of the court below in this case has completely disturbed the settled view which has prevailed until now, in consequence of which confusion and conflict must necessarily result.

Wherefore, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Court of Appeals for the Second Circuit, commanding that court to certify to and send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket No. 21112, In the Matter of Calton Crescent, Inc., Debtor, Manufacturers Trust Company as Trustee under an Indenture made by the Debtor under date of September 27, 1933, and individually, Objector-Appellant, against Regine Becker, Emily K. Becker and Walter A. Fribourg, Claimants-

Appellees, and that the judgment of the said Court of Appeals for the Second Circuit may be reversed by this Honorable Court, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

Dated: New York, N. Y., April 19, 1949.

MANUFACTURERS TRUST COMPANY, as Trustee under an Indenture made by the Debtor under date of September 27, 1933, and individually,

Petitioner,

By EDWARD K. HANLON,
Counsel for Petitioner.

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~~REGINE BECKER,~~ EMILY K. BECKER and WALTER A. FRIBOURG,

Respondents.

BRIEF IN SUPPORT OF PETITION

Opinions Below

The opinion of the Referee (A. 100-101) is not reported.

The opinion of the District Court (per GODDARD, J.) (A. 116-122) is reported at 80 Fed. Supp. 822.

The opinions in the Court of Appeals (C. 8-25) are not yet reported.

Jurisdiction

The order and judgment of the Court of Appeals for the Second Circuit sought to be reviewed was entered on March 3, 1949 (C. 26-27).

The jurisdiction of this Court is invoked under Section 24 (c) of the Bankruptcy Act and Title 28, United States Code, Section 1254 (1).

Statement of Facts

The facts have been stated in the petition.

Specification of Errors

It is submitted that the court below erred:

(1) In affirming the decree of the District Court.

(2) In holding that the proofs of claims of the respondents should be allowed in the full face amount thereof.

(3) In failing to hold that directors of an insolvent corporation may not profit from their dealings in debt securities of their corporation and that claims based upon such securities should, upon a distribution of the corporation's assets in a subsequent bankruptcy proceeding, be limited to the actual amounts paid by them for such debt securities.

(4) In failing to hold that the respondents, two of whom were relatives of directors, who exercised no independent judgment of their own and for whom the directors acted as agents, and one of whom was associated with directors and acted in conjunction with them, are to be treated in the same manner as if they were directors in respect of the allowance of their claims upon a distribution of the debtor's assets.

Summary of Argument

I

Directors of an insolvent corporation are fiduciaries, and the standards of their obligations as such fiduciaries are designed for the protection of the entire community of interests in the corporation, and these standards are not satisfied by a mere holding that it does not appear that in purchasing debt securities of their corporation the sellers of such securities were not overreached. Relatives and associates, such as these respondents, are in like position.

II

The decision below is in direct conflict with decisions of the Courts of Appeals for the Sixth, Seventh and Tenth Circuits.

ARGUMENT

I

Directors of an insolvent corporation are fiduciaries, and the standards of their obligations as such fiduciaries are designed for the protection of the entire community of interests in the corporation, and these standards are not satisfied by a mere holding that it does not appear that in purchasing debt securities of their corporation the sellers of such securities were not overreached. Relatives and associates, such as these respondents, are in like position.

It is not disputed that during all the period when the respondents purchased the securities on which their claims are based the corporation was insolvent. Nevertheless

the majority of the Court of Appeals has held that even if the respondents had been directors their claims should be allowed in full because it did not appear that they had overreached those from whom they purchased such securities. We know of no other case where such a principle has been applied.

The real test is whether the corporate fiduciary may act in his own interest, reaping profits from such transactions, or must turn such profits over to the corporation's creditors for whose benefit he should have been acting.

This Court in *Pepper* v. *Litton*, 308 U. S. 295 (1939), in speaking of the fiduciary obligations of directors, said (p. 307):

> "For that standard of fiduciary obligation is designed for the protection of the entire community of interests in the corporation—creditors as well as stockholders."

To ignore the balance of the community of interest and to make the standard of determination harm to the sellers of the securities imports a false conception. A somewhat similar contention was made in *Wendt* v. *Fischer*, 243 N. Y. 439, where brokers brought about the sale of their principal's property to a corporation of which one of them was an officer and director (although not personally interested) and defended their conduct by taking the position that the principal had obtained the terms upon which he was willing to sell. Judge Cardozo repudiated such a test in the following language (p. 443):

> "Finally we are told that the brokers acted in good faith, that the terms procured were the best obtainable at the moment, and that the wrong, if any, was unaccompanied by damage. This is no sufficient answer by a trustee forgetful of his duty. The law

'does not stop to inquire whether the contract or transaction was fair or unfair. It stops the inquiry when the relation is disclosed, and sets aside the transaction or refuses to enforce it, at the instance of the party whom the fiduciary undertook to represent, without undertaking to deal with the question of abstract justice in the particular case' (citing cases). Only by this uncompromising rigidity has the rule of undivided loyalty been maintained against disintegrating erosion.'

That we are not inaccurate in asserting that the court below adopted the very contention which Judge Cardozo repudiated is manifest from the following language in the majority opinion (C. 19):

"After insolvency it may be said that the directors are fiduciaries for the group of creditors who will share in the insolvent's estate. But the creditors who have retained their claims will suffer nothing whether or not the director is allowed to make a profit from his purchases. If a wrong has been done to any of the group of cestuis, it is to those who sold their claims at a price less than the dividend they would have received had they retained them."

It is obvious that this line of reasoning ignores this Court's comment, above referred to, in *Pepper* v. *Litton* (*supra*) that the standards of the directors' fiduciary obligations are designed for the protection of the entire community of interests in the corporation.

The real problem involved here is whether or not the obligations of a director as a fiduciary not to traffic in the trust property are to be maintained. As indicated in the dissenting opinion (C. 23), directors of an insolvent corporation are trustees for its creditors and any profit which they may obtain through self-dealing in the trust assets belongs to their cestuis, in this case the remaining creditors.

The result in the court below, which in actuality emasculates that well settled principle, runs counter to the theory of the decisions upon the subject in both federal courts of appeal and district courts. We will discuss the decisions of the courts of appeals hereafter (Point II) as being in direct conflict with the decision of the court below, and confine our remarks here to references to the decisions of the district courts.

There is a careful and well reasoned discussion of this precise matter in *In Re Los Angeles Lumber Co., Ltd.*, 46 Fed. Supp. 77 (D.C.S.D. Cal. 1941) where a director had purchased substantial amounts of the debt securities of his insolvent corporation, some of which he had bought for the purpose of turning them over to the corporation if it should obtain sufficient funds to reimburse him. As to all of these securities the director was held, in the subsequent bankruptcy proceedings, to be limited to the amount that he paid for such securities. The same result was reached with regard to another corporation which participated with him in some of the purchases with knowledge of the facts. There was no overreaching of the sellers; on the contrary the director advised all bondholders of the debtor who inquired of him not to sell their bonds unless they had to.

The following comments in the court's opinion (p. 88) reflect the principles which have been applied in the federal courts until the decision in the instant case:

> "It has, of course, long been established that officers, directors and attorneys of a corporation are fiduciaries and that they should be held responsible for any breach of duties as such. *They may not, while the corporation is insolvent, purchase claims against it at a discount and then enforce such claims at their full face value. Bonney* v. *Tilley*, 1895, 109 Cal. 346, 42 P. 439; *Davis* v. *Rock*

Creek Lumber, etc., Co., 1880, 55 Cal. 359, 36 Am. Rep. 40. When the corporation is not only insolvent but has filed its petition under Section 77B or Chapter X of the National Bankruptcy Act as amended, 11 U.S.C.A. §501 *et seq.*, and the directors have become trustees of the debtor in possession, the directors' obligations as trustees become even more rigorous. *In re Norcor Mfg. Co.*, 7 Cir., 109 F. 2d 407; *Pepper* v. *Litton*, 308 U. S. 295, 60 S. Ct. 238, 84 L. Ed. 281.

The good faith or innocent motives of the fiduciary, or his well-intentioned purpose to effectuate a plan of reorganization, constitute no defense to liabilities founded upon breaches of fiduciary obligations. *In re McCrory Stores, Corp.*, D.C.S.D. N. Y., 1935, 12 F. Supp. 267, 269, 30 Am. Bankr. Rep., N.S., 670.

* * * * * * *

And it is likewise no defense to say that fraud was not intended and that unfairness did not result from the trustee's actions. *Magruder* v. *Drury*, 235 U. S. 106, 120, 35 S. Ct. 77, 59 L. Ed. 151; *Jackson* v. *Smith*, 254 U. S. 586, 589, 41 S. Ct. 200, 65 L. Ed. 418; *Tomblin* v. *Hill*, 206 Cal. 689, 275 P. 941. Actual fraud in such cases is not necessary to give the client redress. A breach of duty is constructive fraud. *Baker* v. *Humphrey*, 101 U. S. 494, 25 L. Ed. 1065. There are many situations, in which a constructive trust is imposed even in the absence of fraud. 3 Scott on Trusts, §462." (Italics supplied.)

District Court cases involving similar situations with like results are *In Re Jersey Materials Co.*, 50 Fed. Supp. 428 (D.C. N.J. 1943), *In Re Philadelphia & Western Railway Co.*, 64 Fed. Supp. 738 (D.C.E.D. Pa. 1946) and *In Re McCrory Stores Corp.*, 12 Fed. Supp. 267 (D.C.S.D. N. Y. 1935).

The circumstance that the respondents were not directors is a little moment here. Two of the respondents

were relatives of the directors, one the mother of Norman and Sanford Becker and another the wife of Sanford Becker. Sanford purchased the debentures as their agent and they themselves exercised no independent judgment in the matter. Fribourg, while not a relative, was an associate of the Becker brothers, his brokerage account was utilized for the purchase of securities for the other respondents and the Becker brothers cooperated with him in the purchase of many of the securities upon which he now bases his claim. Obviously, to permit fiduciaries to conduct transactions forbidden to them, by acting as agents for the mother and wife, and by cooperating with the third respondent in the purchase of securities acquired by him, would be to make a travesty of the basic rule and encourage the very thing which the rule forbids.

Such conduct was not permitted in *In Re Los Angeles Lumber Products Co., Ltd.* (*supra*) in *In Re Jersey Materials Co.* (*supra*) and *In Re Norcor Mfg. Co.*, 109 F. 2d 407 (7 C.C.A. 1940) (discussed hereafter).

Manifestly the decision below has made unsettled what previously was the prevailing belief in the federal courts, as pointed out by Judge Learned Hand in his dissenting opinion in this case (C. 23), and, therefore, raises a question which has not been passed upon by this Court and which should be settled by this Court.

II

The decision below is in direct conflict with decisions of the Courts of Appeals for the Sixth, Seventh and Tenth Circuits.

The decision of the court below is in direct conflict with the decision of the Court of Appeals for the Sixth Circuit in *In Re Van Sweringen Company*, 119 F. 2d 231 (1941

cert. den. sub nom. *Terminal & Shaker Heights Realty Co. v. Van Sweringen*, 314 U. S. 671); with the decision of the Court of Appeals for the Seventh Circuit in *In Re Norcor Manufacturing Co.*, 109 F. 2d 407 (1940 cert. den. 310 U. S. 625); and with the decision of the Court of Appeals for the Tenth Circuit in *Monroe* v. *Scofield*, 135 F. 2d 725 (1943). We will discuss these three cases in the order named.

In Re Van Sweringen Company.—There the Vaness Company was the majority stockholder of two debtor companies, one of which in turn owned all the stock of the Cleveland Terminal Building Company, a subsidiary debtor. The Van Sweringen brothers were officers and directors of all these companies. In May, 1930, the Vaness and Cleveland companies borrowed $39,500,000 from J. P. Morgan & Company evidenced by notes and secured by certain collateral securities. Upon default on the notes in May, 1935, the collateral securities were to be sold at public auction in September. In August of the same year, the Van Sweringens formed the Midamerica Corporation whose successor was the claimant in the proceeding. The agreement setting up this corporation provided that one Ball and one Tomlinson would put up $2,000,000 and the Van Sweringens would have an irrevocable option to purchase 55% of the common stock for a period of 10 years and obtain control of the board of directors. At the auction sale Midamerica bought in the notes of the debtors together with the collateral securities which were conceded to have a value greater than the total amount paid. The notes of the three debtors purchased were carried on Midamerica books at $1, $2 and $887, respectively. The claimant sought in the debtors' reorganization to enforce a claim on these notes at their total face value of $39,500,000.

The court limited the claims to $1, $2 and $887 plus interest from the date of acquisition saying (p. 234):

> "From the manner and under the circumstances in which, in association with outside enterprisors, the Van Sweringens, *as directors of insolvent corporations*, purchased these claims against their cestui que trustent, the debtors, herein, at substantially less than real values, equity and good conscience demand that the claims of their corporate creature, Midamerica (predecessor to appellant), be limited to the amounts actually paid by it for the notes and bonds of the insolvent corporations." (Italics ours.)

In Re Norcor Manufacturing Co.—There one Krueger was the principal stockholder and director of the Norcor Manufacturing Co., the debtor, which had confessed insolvency in the state court. Ten months later Krueger hired an attorney, one Lehner, for the purpose of reorganizing the debtor. Lehner was furnished with a list of stockholders, financial statements and other pertinent data and he then solicited creditors of the debtor, offering to purchase their claims at 10 to 30% of their face value. Krueger assigned his controlling stock to a third person who reassigned the same to the Norcor Company, a new corporation whose board of directors was controlled by Krueger and Lehner. Lehner continued to offer to purchase such claims and assignments of such claims were made to Lehner, his wife, Krueger and Krueger's son, all of whom reassigned such claims to the new corporation. These claims totaled $65,016.73, for which amount the new company made a claim in the debtor's reorganization. The actual amount paid for such claims was $13,331.13.

The court limited the claims to the amount actually paid for them, saying (p. 411):

"It is argued that Krueger and his attorney Lehner sustained such a fiduciary relation with the debtor corporation as would preclude them from purchasing claims of creditors at a small fraction of their face value, and using them as the foundation for a claim in excess of that actually paid therefor. We think this argument is sound. Certainly Krueger, as Managing Director, occupied such position."

The court then quotes from this Court's opinion in *Pepper* v. *Litton* (*supra*) and continues:

"As Krueger occupied a fiduciary relation, so did his attorney Lehner. Neither of them would have been entitled to the allowance of a claim in an amount which would have inured to his individual profit. Being thus precluded as individuals, they had no right to accomplish the same purpose under the guise of a corporate entity."

Monroe v. *Scofield.*—There a director purchased a judgment against his corporation after the commencement of bankruptcy proceedings against it. The court limited the claim to the amount paid, saying (p. 728):

"Where a corporation is a going concern, a director may purchase a claim against the corporation at a discount and enforce it for the full amount, absent a present duty on his part to act for the corporation. However, where the corporation is insolvent, he is precluded from recovering more than he paid for the claim unless by an order of the court or otherwise he has been shorn of all power in the corporate management and his trust relationship has been fully terminated."

Each of the foregoing three decisions expressly holds that a director or his associates may not purchase a claim against his corporation while it is insolvent, and enforce it at its full face amount in bankruptcy proceedings.

Whether or not the purchase is made before or after bankruptcy proceedings have been brought is not made a test in any one of these cases. As a matter of fact in the *Van Sweringen* case the reorganization proceedings did not commence until a year after the transaction. (We obtain the date of the commencement of the proceedings from a related case, *Gochenour* v. *Cleveland Buildings Co.*, 142 F. 2d 991, 992 (C.C.A. 6, 1944).) In the *Norcor Manufacturing* case the corporation was in a state receivership but not in bankruptcy. In *Monroe* v. *Scofield* bankruptcy proceedings had begun when the claim was acquired.

Without laboring the point, we submit that it is manifest that the decision in the court below in the instant case is in direct conflict with each of these three decisions.

CONCLUSION

A writ of certiorari should be granted.

Dated: New York, N. Y., April 19, 1949.

Respectfully submitted,

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